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SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - C. PLANTIER AND MMILLS

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SUBJECT: New Data Continue Pattern of Stubbornly-High
Unemployment Rates

1. Summary: The National Statistics Office (SIS) announced that the unemployment rate was 11.5 percent in January, higher than the year-end 2004 rate of 10.3 percent. Seasonal factors and the use of a new methodology, however, mean that it is not clear the higher rate reflects a worsening unemployment trend. The workforce in Turkey is growing by more than 1 percent per annum, and is expected to grow at that rate for another decade. The GOT hopes that its economic policies will create at least 600,000 new jobs per year to start bringing the unemployment rate down. Unemployment remains high due to a combination of high employment taxes, population growth, and improved productivity. End Summary.

New Methodology Produces Higher Unemployment Rate:

2. The SIS announced its January 2005 work force survey results on April 25. Using a new methodology (see below), the survey found an unemployment rate of 11.5 percent, compared to final 2004 unemployment of 10.3 percent. Though the reasons for the large difference are not clear, they appear to stem from some combination of seasonality and the change in methodology. The seasonality arises from higher unemployment in the winter, particularly in construction.

3. As for the methodological difference, this is the first time that the SIS announced its data on a monthly basis, using a moving average of the survey results for the December 2004 - February 2005 period. The SIS used to announce its data on a quarterly basis. The averaged January 2005 data put the employment rate at 41.3 percent and size of the workforce at 23.5 million. The number of unemployed was recorded as 2.7 million, under-employment at 3 percent and non-agricultural unemployment at 15.2 percent.

The Downside of Improved Productivity:

4. Echoing many economic analysts, IMF Europe Director Michael Deppler, was recently quoted saying that the extraordinarily high increases in productivity in the last three years explained the failure of Turkey's strong growth to bring down the rate on unemployment. According to the SIS productivity index labor productivity increased an average of 6.6 percent for each quarter since 2002. Turkish Labor Minister Basesioglu predicted on April 20 that despite improved productivity companies would begin to start hiring new employees.

High Tax Wedge:

5. Another factor in Turkey's high unemployment rate is the high tax "wedge"-i.e. employment taxes, including social security premia. Turkey's tax wedge is above the OECD average. When GOT officials raise the issue of tax reductions, the preferred tax reduction in the IMF's view would be a cut in employment taxes. However, social security premia cannot be cut because of the need to rein in huge social security deficits. The IMF has reflected the desirability of lower employment taxes in its new program, which calls for consideration of cuts in employment tax rates down the road, fiscal situation permitting. TUSIAD (Turkish Industrialists and Businessmen Association) President Omer Sabanci was quoted saying that the GOT should rapidly start implementing job-creation remedies and urged the GOT for a employment-tax cuts. According to a TUSIAD report a 10 percent decrease in employment taxes would lead to significant decrease in the manufacturing industry cost of production, and would increase employment rate by 2 pp in the long-run.

The Unregistered Economy Problem:

6. According to the official SIS data, of the 20.8 million work force only 10.6 million employees are registered under the social security system. The unregistered employees are

estimated to cost the Turkish state around TRY 19.5 billion. According to the 2004 OECD Economy Survey report, Turkey faces a serious dilemma in employment policy: Will the GOT cut labor taxes in the formal sector to stimulate labor demand and supply, or let the non-taxed informal economy continue to play a buffer role and absorb employment at the low end of the labor market?

Hopes of Job Growth?

17. Going forward, the slow pace of employment growth is an increasingly high-profile political issue for the Government, and one on which the GOT hopes there may be some modest improvement. A TUSIAD report on unemployment also supports the view that despite some capital growth in 2005, there would be a surge in the employment rate, increasing by 1.5 - 2.0 percent - an increase below the threshold needed to prevent the 2005 unemployment rate from coming in above 10 percent. Deputy Prime Minister Abdullatif Sener announced on April 27 that the GOT would discuss employment creation remedies --the GOT is aware of the social and political danger of the unemployment rate worsening, as signaled by the January 2005 data. Prime Minister Tayyip Erdogan already said on April 4 a 10.3 percent unemployment rate was still high for Turkey, and the GOT would implement policies primarily in the construction sector to create 600,000 new jobs every year. The GOT projects unemployment rates of 9.6 percent and 10 percent for 2006 and 2005, respectively, corresponding to 23.7 million and 23.1 million employed people.

18. A survey carried out by the Istanbul Chamber of Industry among its members also reveals that 62 percent of the enterprises have reached new investment decisions. ISO President told Econ specialist that industrialists were generally hopeful about 2005, but increasing productivity means there may be no improvement in the unemployment rate. On the other hand, according to State Minister Ali Babacan, the unemployment rate could decrease to 7 percent in the next three years with a 5 percent growth rate. Minister Babacan said in a conference he attended in February 2005 that the GOT expected a total of 1 million 650 thousand people to be employed in 2005, 2006 and 2007 given a 5 percent growth rate.

Underemployment:

19. Some analysts believe that official unemployment data underestimate the problems in the Turkish labor market, as suggested by Turkey's substantial underemployment. Fourth quarter 2004 data showed that underemployment constituted 4.1 percent of the work force, whereas this rate dropped to 3 percent in the January 2005 data, using the new methodology. This shows that as of January 2005, about 14.5 percent of the work force is either unemployed or underemployed in Turkey. A Turkish labor market risk analysis report by the Economic Intelligence Unit points out that unskilled and semi-skilled labor is abundant and wages are low in Turkey. The lack of a good skills match between what employers want and the available supply of workers also contributes to "structural unemployment" in Turkey.

110. Comment and conclusion: Turkey is growing at an impressive rate, inflation is decreasing, but the unemployment rate is not coming down, given that labor force is also growing, and productivity is increasing. The GOT is aware of the problem, but trying to find solutions without being in conflict with the economic reform program. Taxes and social security contributions that are seen as key barriers to employment creation put the GOT in a dilemma between employment tax rate cuts and revenue collection. Edelman